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Supreme Court, U.S.
FILED
AUG 6 1997
CLERK

No. 96-1470

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

QUALITY KING DISTRIBUTORS, INC.,

Petitioner,

v.

L'ANZA RESEARCH INTERNATIONAL, INC.,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF *AMICI CURIAE*, COSTCO COMPANIES, INC., WAL-MART STORES, INC., TARGET STORES, A DIVISION OF DAYTON HUDSON CORPORATION, NATIONAL ASSOCIATION OF CHAIN DRUG STORES, INTERNATIONAL MASS RETAIL ASSOCIATION, NATIONAL ASSOCIATION OF CATALOG SHOWROOM MERCHANDISERS, and THE FOOD MARKETING INSTITUTE, IN SUPPORT OF PETITIONER

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INTEREST OF *AMICI CURIAE*

Amici have received written consents to file this brief from petitioner and respondent and are filing these consents separately with the Clerk of the Court.[1]

1. The Individual *Amici*

Costco Companies, Inc. ("Costco") through its subsidiaries operates "Costco Wholesale" and "Price Club" membership warehouse clubs in the United States and abroad. Costco's annual sales of over $20 billion make it the seventh largest retailer in the United States, and approximately 20,000,000 U.S. cardholders shop at its warehouse locations.

Wal-Mart Stores, Inc. is the largest retailer in the United States, with over $104 billion in annual sales. It operates both "Wal-Mart" stores (2,565 U.S. locations) and "Sam's" membership warehouse clubs (438 U.S. locations).

Target Stores, a division of Dayton Hudson Corporation, accounted for over 70% of the corporation's 1996 annual sales revenue of more than $25 billion dollars, making Dayton Hudson the fifth largest general merchandise retailer in the United States. Target operates 769 stores in 39 states.

Each of the individual *amici* will be immediately affected by the decision in this case. Each sells a wide range of merchandise that includes imported goods with copyrighted labels or features. Since 1994, Costco has been sued four times, solely in the Ninth Circuit, on claims that its sales of genuine goods violate Section

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[1] No counsel for either of the parties authored this brief in whole or in part. No person or entity, other than *amici curiae*, their members and their counsel, made a monetary contribution to the preparation or submission of this brief.

602(a) of the Copyright Act.[2] One of those lawsuits was brought by respondent. Wal-Mart has been sued on the same theory.[3] A decision in this case recognizing a Section 602(a) claim will subject the individual *amici* to future liability for selling genuine products with copyrighted labels in the normal course of their businesses, and impose barriers and additional costs when purchasing such products from anyone other than the U.S. copyright owner.

2. The Association *Amici*

National Association of Chain Drug Stores has approximately 130 members that operate 25,419 retail chain drug store outlets throughout the United States. Its members generate over $110 billion in sales. A list of its members is in the Appendix, *infra* at 1a.

International Mass Retail Association ("IMRA") represents 180 member companies, including discount department stores, home centers, category-dominant or specialty discounters, catalogue showrooms, dollar stores, warehouse clubs, deep discount drugstores and off-price stores. Collectively, IMRA retail members operate more than 70,000 stores in the U.S. and abroad and employ over two million Americans. IMRA retail members cumulatively represent over $380 billion in annual sales.

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[2] *Disenos Artisticos E Industriales S.A. v. Costco Wholesale Corporation*, 97 F.3d 377 (9th Cir. 1996); *Swarovski America Ltd. v. Price/Costco Inc., et al.* and *Swarovski America Ltd. v. Costco Wholesale Corp.*, C.D. Cal. Nos. 93-6365 SVW, 93-7403 SVW (Judgment Dec. 21, 1994); *L'anza Research Int'l, Inc. v. Costco Wholesale Corp.*, C.D. Cal. No. 95-0244 TJH (settled 1995); *Montblanc-Simplo GmbH et al. v. Costco Wholesale Corporation et al.*, C.D. Cal. No. CV 96-1160 DT (settled 1996).

[3] *E.g. Parfums Givenchy, Inc. v. K mart Corporation, Sears Roebuck and Co., Wal-Mart Stores, Inc., et al.*, C.D. Cal. No. 94-764 HLH.

National Association of Catalog Showroom Merchandisers is an association of catalog showroom merchandisers, whose members use catalogs showing brand name products as a principal medium of advertising. It has several hundred members; its member discount retail stores account for approximately $5 billion in annual sales.

The Food Marketing Institute ("FMI") is a nonprofit association conducting programs in research, education, industry relations and public affairs on behalf of its 1,500 members including their subsidiaries – food retailers and wholesalers and their customers in the United States and around the world. FMI's domestic member companies operate approximately 21,000 retail food stores with a combined annual sales volume of $220 billion – more than half of all grocery store sales in the United States. FMI's retail membership is composed of large multi-store chains, small regional firms, and independent supermarkets.

Each of the *amici* associations advocates the freedom of its members to purchase and resell genuine brand name products, to make available such products at competitive prices as determined by each individual retailer, and thereby to compete freely with other forms of retailing. The Ninth Circuit's decision in this case presents a substantial threat to those freedoms. If the decision stands, the retailer members of the *amici* associations will face significant costs and impediments in purchasing and reselling genuine goods having a copyrighted label or feature, affecting substantial commerce. As a result, U.S. consumers who shop at the thousands of retail stores operated by the *amici* associations' members will be denied access to the benefits of open competition, including the lowest possible prices.

SUMMARY OF ARGUMENT

1. When an author creates a work, he or she automatically obtains a copyright virtually worldwide. Although the author may then internationally exploit the copyright by a variety of methods, two prototypes of these methods help illustrate the effect of Section 109(a) on Sections 106 and 602(a) of the Copyright Act. In "Case 1," the copyright owner keeps all worldwide rights for itself and makes and sells all copies of the work, either in the United States or abroad. In "Case 2," the U.S. copyright owner absolutely transfers certain of its foreign rights to others, and the assignee or exclusive licensee of those foreign rights makes and sells the copies in question.

Whether Section 109(a) cuts off the exclusive distribution right referred to in Sections 106 and 602(a) differs between Cases 1 and 2. In Case 1, since the U.S. copyright owner itself will have made the particular copies, those copies will be deemed "lawfully made under this title" for purposes of Section 109(a) and, thus, may be freely sold by downstream purchasers. This is also true if the U.S. copyright owner has made the copies in a foreign country or contracted with a foreign manufacturer to make them abroad. Where, as here, the U.S. copyright owner itself has made the copies in the United States, Section 109(a) explicitly cuts off the exclusive distribution right on which Section 602(a) depends.

By contrast, where an independent owner of foreign rights has made and sold the copies that are subsequently imported (Case 2), those copies will likely be "lawfully made" only under foreign copyright laws, and not "under this title" for purposes of Section 109(a). If so, Section 109(a) would not cut off the Section 106(3) distribution right and that right would survive for purposes of Section 602(a).

If legislative history need be considered, one finds that Section 109(a) is based on the common-law principle prohibiting restraints on the alienation of personal property. When it first enacted the first-sale doctrine, and when it later re-enacted it in Section 109, Congress made clear that it was adopting this common law principle. Once a copyright owner has transferred ownership of a particular copy, the copyright owner may not exercise any control whatever over that copy. In the patent area, where a first-sale doctrine developed in tandem with that of the copyright law, the courts have applied the doctrine where U.S. patent owners have sold patented articles abroad. Similarly, the goal of Section 109(a) is to avoid restraints on downstream owners, no matter if the intellectual property owner has sold the object in the United States or in a foreign country.

In addition, a sale overseas is but one of numerous foreign "operative acts" referred to in, or contemplated by, the Copyright Act. Although courts will not normally *enforce* acts of Congress beyond the territorial boundaries of the United States, this case does not involve enforcement of the Copyright Act in any foreign country. Instead it involves a commercial transaction originating from the United States and directed abroad, that has *legal significance* for rights claimed within the United States. Even if L'anza is deemed to have made a sale abroad, it will not prevent operation of Section 109(a).

2. If, however, Section 602(a) is to be exalted over the apparent command of Section 109(a), its effect should be limited to the sole act proscribed by that provision, "importation." Section 602(a) should not be extended to downstream merchants, like Quality King or *amici* and their members. The "good faith purchaser" rule, which normally protects merchants that deal in genuine goods, should not be overriden by judicial fiat.

ARGUMENT

I.

A SALE TO A FOREIGN MARKET BY THE U.S. COPYRIGHT OWNER ITSELF CUTS OFF THE DISTRIBUTION RIGHT MENTIONED IN SECTION 602(a).

It is useful to analyze this case from the viewpoint of how, internationally, a copyright is originated and may be exploited. Here, L'anza created an original graphic design for its product labels. From the moment of creation, L'anza had a copyright in the United States and most other nations. This occurred both under Section 104 of the Copyright Act, 17 U.S.C. §104, and under the multilateral treaties implemented by the Act. In particular, the Berne Convention and the Universal Copyright Convention give an author in any convention country automatic recognition of, and protection for, his or her works upon their creation. Article 5 of the Berne Convention provides in part:

> (1) Authors shall enjoy, in respect of works for which they are protected under this Convention, in countries of the Union other than the country of origin, the rights which their respective laws do now or may hereafter grant to their nationals, as well as the rights specially granted by this Convention.
>
> (2) The enjoyment and the exercise of these rights shall not be subject to any formality; such enjoyment and such exercise shall be independent of the existence of protection in the country of origin of the work. . . .

Berne Convention for the Protection of Literary and Artistic Works (Paris 1971), S. Treaty Doc. No. 27, 99th Cong. 2d Sess., 40 (1986). Similar provisions appear in Article II of the Universal Copyright Convention, 25 UST 1341 (1971). Section 104 of the Copyright Act implements these international obligations by granting reciprocal protection to works created or published in

countries adhering to the Berne Convention and Universal Copyright Convention, as well as in other foreign nations. *See* 17 U.S.C. §104(b).

This system of treaty rights, thus, gave L'anza instantaneous recognition of its copyright virtually worldwide. Although the protections may vary country by country, L'anza, as the "owner of copyright," controlled the full bundle of rights embodied in its U.S. and foreign copyrights.[4]

A copyright owner may choose different paths to exploit its copyright internationally, including various permutations of assignments and licenses. To illustrate the interaction of Sections 106, 109(a) and 602(a), however, we focus on two prototypical "cases" that result in a sale.[5]

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[4] "Owner of copyright," the term used in 17 U.S.C. §§106 and 602(a), means the owner of the entire copyright. By contrast, a "copyright owner" is defined as, "with respect of any one of the exclusive rights comprised in a copyright, . . . the owner of that particular right." 17 U.S.C. §101. Thus, where U.S. rights have been licensed, a "copyright owner" will not be the "owner of copyright"; rather, "the licensor remains the owner of the copyright, and the licensee is the owner only of the exclusive rights that are the subject of [the] license. . . ." 3 M. Nimmer & D. Nimmer, *Nimmer on Copyright* §10.02[C][2] (1996). Since here L'anza is both the owner of copyright and the copyright owner of all exclusive rights, we use the terms interchangeably.

[5] Besides a sale, a copyright owner may simply lease or entrust a copyrighted object. Leases, for example, are common in motion picture distribution. Similarly, a foreign contract manufacturer or warehouse operator may possess copies while performing services for a copyright owner. If a bailee or lessee breached its agreement with the copyright owner and transferred a copy to a third party, there would not have been any first sale by anyone with rights under the U.S. copyright. Nor would good title be transferred if a copy were stolen from a copyright owner, lessee or bailee, *see Textile Supplies, Inc. v. Garrett*, 687 F.2d 123, 127 (5th Cir. 1982), and, in that case, there would be no subsequent "owner" within the meaning of Section 109(a).

Case 1. A copyright owner may keep for itself, as L'anza has done in this case, all U.S. and foreign rights in its copyright. If the copyright owner chooses this path, it will control the reproduction of all copies of the copyrighted work. If the copyright owner makes those copies in the United States (as L'anza does) or in a foreign country, they will be lawful copies under the laws of all countries. As discussed below, in the eyes of the U.S. Copyright Act the copies will be "lawfully made under this title." 17 U.S.C. §109(a).

In addition, the copyright owner in Case 1 will necessarily control the first distribution of each genuine copy; it will set the price and terms of the first sale, and it has the ability to negotiate contractual restrictions with its immediate purchasers. To market its product internationally, a copyright owner like L'anza could sell to a U.S.-based distributor (with or without an agreement on where the latter may resell). Or, as actually happened here, the owner could sell to a distributor abroad. Under either scenario, importation may occur if a third party purchaser in a foreign nation finds it economical to resell the goods back to a customer in the United States.

Case 2. The second prototype involves an absolute transfer of foreign rights. By an assignment or unconditional exclusive license, a copyright owner may transfer the full bundle of rights under one or more foreign copyrights. If that occurs and if the assignees or licensees reproduce copies in the foreign nations concerned, those copies would be lawfully made in the eyes of the foreign copyright law. However, although genuine copies, they would appear not to have been made under any right or authority derived from the U.S. Copyright Act.

Also under this Case 2, the owner of the U.S. copyright will not usually control sales of the foreign-made

copies; the assignee or exclusive licensee of the foreign rights will set the price and terms of the first sale. Importation might then be the result of the foreign copyright owner selling to a U.S. customer, or of a third party purchaser exporting to the United States.

We submit that L'anza's ability to restrict imports under Section 602(a) differs between Cases 1 and 2. In particular, Section 602(a) does not give a copyright owner the blanket right to keep out all imports of products bearing its copyrighted design. Rather, Section 602(a)'s applicability depends on whether the copyright owner's exclusive right to distribute particular copies (under Section 106) survives until the time of the importation, or whether that right has been cut off (under Section 109(a)) by a prior sale. Section 109(a)'s applicability, in turn, depends on whether the particular copies were made by or for the U.S. copyright owner (Case 1), or made solely under foreign law by an independent owner of foreign rights (Case 2). As we demonstrate below, Section 109(a) operates to extinguish a U.S. copyright owner's rights under Sections 106(3) and 602(a) where, as here, the copyright owner itself has made the copies and put them into the stream of commerce.

A. Section 602(a) Will Not Apply Where The Section 106 Distribution Right Has Been Cut Off By A First Sale Of A Copy That Is "Lawfully Made Under This Title."

In Section 602(a), Congress adopted a middle ground between giving a copyright owner a new right to prohibit imports and allowing unrestricted importation. Congress decided that importation of a particular copy would simply be "an infringement of the exclusive right to distribute copies and phonorecords under section 106. . . ." 17 U.S.C. §602(a). Thus, to have a claim under Section

602(a), the U.S. copyright owner must still have the Section 106 exclusive distribution right for the particular copies that had been imported. But if the Section 106(3) exclusive right to distribute has been cut off (for example, by Section 109(a)'s first sale doctrine), Section 602(a) can no longer (for those copies) state "an infringement of the exclusive right to distribute copies . . . . under section 106." 17 U.S.C. §602(a).

Where it applies, Section 109(a) unquestionably cuts off L'anza's rights under Section 106(3). The exclusive distribution right L'anza is claiming under Section 106(3), for purposes of Section 602(a), is "[s]ubject to sections 107 through 120" (17 U.S.C. §106), which of course encompasses Section 109(a). Conversely, any subsequent "owner" of a product bearing a copy of Lanza's design that has been "lawfully made under this title" is free to resell that copy "[n]otwithstanding the provisions of section 106(3). . . ." 17 U.S.C. 109(a).

On its face, Section 109(a) applies where the U.S. copyrighted owner itself has made the copies (as in the Case 1 scenario), as opposed to an unrelated assignee or licensee solely of foreign rights (the Case 2 scenario, not at issue here).[6] By its language, Section 109(a) applies to copies that have been "lawfully made under this title. . . ." 17 U.S.C. §109(a). This provision asks both whether the copy is a lawful one and whether its reproduction was lawful "under this title." If made by or at the discretion of the U.S. copyright owner, it will be treated as lawful under the Copyright Act.

[6]This case also does not present, and thus the Court should not decide, what would happen if the U.S. copyright owner and the foreign assignee or licensee were under common ownership or control. This was a situation involved in the Court's decision in *K mart Corporation v. Cartier*, 486 U.S. 281 (1988), but is not at issue here.

This is true even where the U.S. copyright owner has the copyrighted article made in a foreign country. For example, if L'anza had a particular copy made in Europe, imported it and then sold it to a U.S. customer, Section 109(a) unquestionably would allow the U.S. customer "without authority of the copyright owner, to sell or otherwise dispose of the possession of that copy. . . ." 17 U.S.C. §109(a). The foreign-made copy would be "lawfully made under this title." *Id.*; *Denbicare U.S.A. Inc. v. Toys "R" Us, Inc.*, 84 F.3d 1143, 1149-50 (9th Cir.), *cert. denied*, ___ U.S. ___, 117 S.Ct. 190 (1996) (goods made for U.S. copyright owner by a Hong Kong manufacturer are covered by Section 109(a)); *cf. Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477, 482 n.8 (9th Cir. 1994), *cert. denied*, ___U.S. ___, 115 S.Ct. 1315 (1995) (copyrighted goods made by a U.S. copyright owner in France are "lawfully made under this title," but, under Ninth Circuit law, sales abroad of such goods do not extinguish rights under Sections 106 and 602(a)).

By contrast, in the Case 2 scenario, if an independent assignee or licensee of foreign rights had made the particular copy, one could say that the copy was "lawfully made," but only under a foreign nation's laws and not "under this title" within the meaning of Section 109(a).

Because here the U.S. copyright owner made the particular copies (and did so in the United States), the language of Section 109(a) (together with that of Sections 106 and 602(a)) should be dispositive. Yet, if it need be considered, the underlying purpose of Section 109(a) supports the same result. As shown below, Section 109(a) and its precursors were intended to preclude a U.S. copyright owner from selling a copyrighted object and then invoking federal copyright remedies to restrain future

alienation of that object – even where the U.S. copyright owner sells to a foreign market.

B. Section 109's Policy Against Restraints On Alienation Applies Even Where A U.S. Copyright Owner Sells To A Foreign Market.

1. Section 109(a) did not simply materialize in the Copyright Act of 1976; its roots are far more deep:

> Section 109(a) *restates* and confirms the principle that, where *the copyright owner* has transferred ownership of a particular copy . . . the person to whom the copy . . . is transferred is entitled to dispose of it by sale, rental, or any other means

House Report No. 94-1476, 94th Cong. 2d Sess. 79 (1976) (emphasis added). In particular, Section 109 restated a rule from the 1909 Act which, in turn, codified a body of judicial precedent:

> Section 41 is not intended to change in any way *existing law* . . . . [I]t would be most unwise to permit the copyright proprietor to exercise *any control whatever* over the article which is the subject of copyright after said proprietor has made the first sale"

House Report No. 2222, 60th Cong. 2d Sess. 28-29 (1909) (emphasis added).

The "existing law" codified in the 1909 Act focused on the Anglo-American rule prohibiting restraints on the alienation of chattels. The courts of both the United States and England had held that, where a copyright owner itself had sold an object embodying a copyrighted work, (1) normal rules against a seller imposing restraints on the subsequent alienation of that object would apply, and (2) the copyright owner/seller would have to look to contract law, not copyright legislation, for claims against

purchasers of the object. A lucid summary appeared in *Henry Bill Publishing Co. v. Smythe*, 27 F. 914 (S.D. Ohio 1886):

> [W]henever the owner of the copyright undertakes, by contract, to attach conditions to his sale of copies of the work, he must rely on the ordinary remedies for a breach of the contract, if it be violated; and this is sound doctrine. Inseparably with the transfer of the title in any copy of the work must go the right of alienation, so far as the peculiar protection of the copyright statutes is concerned . . . .
>
> * * *
>
> A genuine copy, owned by the owner of the copyright, carries with it the ordinary incidents of alienation belonging alike to all property, and, if he parts with the copyright, he retains with the ownership of the particular copy this power of sale; or if he sells a copy to another, having, as owner of the copyright, authorized a transfer, the purchaser takes the copy with the ordinary incident of alienation belonging to all property; and that copy is no longer under the copyright law.

27 F. at 923, 925. *Accord Harrison v. Maynard, Merrill & Co.*, 61 F. 689 (2d Cir. 1894).[7]

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[7] The following English cases, discussed in *Henry Bill Publishing Co.*, 27 F. at 923-24, reached the same conclusion: *Murray v. Heath*, 1 Barn. & Adol. 804 (an owner of a genuine copy not liable under copyright statute for breaching agreement not to sell that copy); *Taylor v. Pillow*, 7 Eq. Cas. 418 (same); *Howitt v. Hall*, 10 Wkly. Rep. 381 (an exclusive licensee after his license terminated had the power to sell copies he had made during the license term). *See also Clemens v. Estes*, 22 F. 899, 900 (D. Mass. 1885); *Doan v. American Book Co.*, 105 F. 772, 776 (7th Cir. 1901); *Kipling v. G.P. Putnam's Sons*, 120 F. 631, 634 (2d Cir. 1903); *Bobbs-Merrill Co. v. Snellenburg*, 131 F. 530, 532 (E.D. Pa. 1904) ("the right to restrain the sale of a particular copy of the book . . . has gone when the owner of the copyright and of that particular copy has parted with all his title to it. . . .")

In *Bobbs-Merrill Company v. Straus*, 210 U.S. 339 (1908), this Court held that Congress had not intended to give copyright owners the power to restrain the resale prices of downstream purchasers, and that normal rules of sales law still applied:

> It is not denied that one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition.

Id. at 350. The cases preceding the 1976 enactment of the current Copyright Act similarly reaffirmed that the first sale doctrine is intended to avoid restraints on the alienation of copies in the hands of subsequent purchasers. *See RCA Mfg. Co. v. Whiteman*, 114 F.2d 86, 88, 89 (2d Cir. 1940) (L. Hand); *Independent News Co. v. Williams*, 293 F.2d 510, 517 (3d Cir. 1961) ("where the publisher has parted with the title to the copyrighted work and despite the fact that as between the immediate parties there is a contractual restriction on its use, this restriction does not bar subsequent purchasers from vending . . . free of the restriction"); *Burke & Van Heusen v. Arrow Drug, Inc.*, 233 F. Supp. 881, 882-83 (E.D. Pa. 1964); *C.M. Paula Company v. Logan*, 355 F.Supp. 189, 191 (N.D. Tex. 1973) (upon sale, "the policy favoring a copyright monopoly for authors gives way to the policy opposing . . . restraints on alienation").

Congress reaffirmed this policy when it enacted Section 109(a). In discussing Section 109(a), the 1976 committee reports observed that "the outright sale of an authorized copy of a book frees it from any copyright control over its resale price or *other conditions of its future distribution.*" House Report No. 94-1476, *supra* at 79

(emphasis added); Senate Report No. 94-473, 94th Cong. 1st Sess. 71 (same). Then in 1984, in connection with the amending of Section 109 to exempt from the first-sale doctrine the leasing of sound recordings, *see* 17 U.S.C. §109(b), the policy was stated even more directly:

> The first sale doctrine has its roots in the English common law rule against restraints on alienation of property. American courts have affirmed the doctrine and distinguished between the owner's exclusive rights in the copyright and the rights of the owner of an object embodying a work that is under copyright.

House Report No. 987, 98th Cong. 2d Sess. 2 (1984), citing Chafee, *Equitable Servitudes on Chattels*, 41 Harv.L. Rev. 945, 982 (1928); *Bobbs-Merrill Co. v. Straus, supra; Harrison v. Maynard, Merrill & Co., supra.*

2. The courts have long applied these principles to foreign sales, in situations similar to our Case 1 scenario. In particular, patent decisions have taken an international approach to the policy against restraints on alienation.[8]

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[8] Patent law may be considered in copyright cases "because of the historic kinship between patent law and copyright law." *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417, 439 (1984). Also, copyright law developed a first sale doctrine in tandem with patent law. *See Adams v. Burke*, 84 U.S. (17 Wall.) 453, 456, (1873) (after being sold, a patented object "is open to the use of the purchaser without further restriction on account of the monopoly of the patentees"); *Bloomer v. McQuewan*, 55 U.S. (14 How.) 539 (1852) (when a patented machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. . . . And if [the inventor's] right to the implement or machine is infringed, he must seek redress in the courts of the State, according to the laws of the State and not . . . under the law of Congress granting the patent").

In *Holiday v. Mattheson*, 24 F. 185 (C.C.N.Y. 1885), a U.S. patent holder sold a patented article in England and then tried to enjoin resale in the United States. The court held that where there was such an unrestricted foreign sale by the U.S. patent owner, "the purchaser acquires the whole right of the vendor in the thing sold: the right to use it, to repair it, and to sell it to others. . . ." The Second Circuit adopted the same view in *Curtiss Aeroplane & M. Corp. v. United Aircraft E. Corp.*, 266 F. 71 (2d Cir. 1920), where an owner of both U.S. and foreign patents sold a Canadian-made airplane to the British government and then sued a downstream purchaser who had brought the airplane to the United States:

> If a patentee or his assignee sells a patented article, that article is freed from the monopoly of any patents which the vendor may possess. . . . If the vendor's patent monopoly consists of foreign and domestic patents, the sale frees the article from the monopoly of both his foreign and his domestic patents, and where there is no restriction in the contract of sale the purchaser acquired the complete title and full right to use and sell the article *in any and every country*.

Id. at 78 (emphasis added). *See Seiko v. Refac Technology*, 9 U.S.P.Q. 2d 1046, 1049 (S.D.N.Y. 1988) (a sale ends the patent owner's right in the patented object, "even if that sale takes place abroad").

Where a copyright owner like L'anza has chosen to retain the entire worldwide bundle of rights for itself, it has the right both to make copies and to sell them everywhere. Because L'anza has these rights in both the United States and the United Kingdom, a sale in either country frees the particular copy sold of the copyright monopoly

(*i.e.*, of the exclusive distribution right), and deprives L'anza of the ability later to invoke copyright law to restrain a subsequent alienation of that copy.

In essence, Section 109(a) does not depend on an exercise of the distribution right in the United States. Instead, it protects all subsequent "owners" of any copies "lawfully made under this title." Its purpose was not to ensure that U.S. copyright owners actually exercised a distribution right within the United States, but to preclude restraints on alienation at least as to copies the U.S. copyright owner itself has made and sold.

3. Had L'anza chosen the Case 2 path and transferred some of its foreign rights, the result would appear to be different if the goods had been made and sold by the foreign assignee or licensee. This Court addressed such a scenario in the patent context, in *Boesch v. Graff*, 133 U.S. 697 (1890). There, U.S. and German rights were divided between two owners: Graff held the U.S. rights and an individual named Hecht owned the German rights. A dealer in the United States bought a burner made and sold by Hecht under the German patent. The Court ruled that the first sale by the German owner could not defeat rights of the separate U.S. owner:

> The right which Hecht had to make and sell the burners in Germany was allowed him under the laws of that country, and purchasers from him could not be thereby authorized to sell the articles in the United States in defiance of the rights of patentees under a United States patent.

Id. at 703. *Accord Griffin v. Keystone Mushroom Farm, Inc.*, 453 F.Supp. 1283 (E.D. Pa. 1978) (sale by an exclusive licensee of Italian rights of a product the licensee made in Italy did not release the product from the U.S. patent monopoly); *cf. Sanofi, S.A. v. Med-Tech Veterin-*

arian Products, 565 F. Supp. 931 (D.N.J. 1983) (first sale abroad by an owner of both the French and U.S. patents did not preclude an exclusive licensee of all U.S. rights from enjoining subsequent U.S. sales). These decisions suggest that if L'anza had decided to exploit its copyright internationally by an absolute assignment or exclusive license of its foreign rights, and if the imports at issue had been made and previously sold by an independent foreign owner or licensee rather than L'anza itself, the first sale doctrine might not defeat the Section 106 distribution right – or, therefore, a claim under Section 602(a).

Here, however, L'anza kept all rights. It made the copies. Those copies, "lawfully made under this title," 17 U.S.C. §109(a), were sold by L'anza itself. Both the language and policy of Section 109(a) have a single thrust: L'anza's own sales of goods L'anza itself made, cut off (for those goods) the Section 106 exclusive distribution right on which any Section 602(a) claim depends. L'anza cannot afterwards restrain distribution of those same copies.

C. Operative Acts By The U.S. Copyright Owner In Foreign Nations Affect Rights Under A U.S. Copyright.

The district court concluded that a sale intended for a foreign market should be deemed to have occurred abroad, and that Section 109(a) could not cut off rights under Section 602(a) where a foreign sale preceded importation._ Petition at B5-B6 and n.5. The district court was incorrect.[9] Any prior sale by a U.S. copyright owner should be viewed as an "operative act" which, even

[9]The Ninth Circuit itself declined to follow the district court's "place of sale" rationale. Petition at A8-A9.

if it occurs abroad, has legal consequences under the Copyright Act.

Although it is sometimes loosely said that the Copyright Act does not have extraterritorial effect, this has generally been understood to mean that the Act does not punish infringements that occur entirely outside the United States. *See Subafilms Ltd. v. MGM-Pathe Communications Co.*, 24 F.3d 1088, 1093 (9th Cir.) (*en banc*), *cert. denied*, ___ U.S. ___ , 114 S.Ct. 512 (1994). This case, however, does not involve a claim that Congress has attempted to "enforce its laws beyond the territorial boundaries of the United States." *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991). Instead, this case involves a commercial transaction originating within the United States and directed to a foreign country, which has *legal significance* for enforcement within the United States. In fact, even if the L'anza products had been made abroad and even if the sales had occurred entirely abroad, they would still be among those "operative acts" occurring in a foreign country that affect rights under a U.S. copyright.

The Copyright Act mentions several such foreign operative acts. As noted, Section 104 confers "protection" under the U.S. Copyright Act where works are published in foreign nations that are parties to the Berne Convention, the Universal Copyright Convention, or some other "copyright treaty," or where the President finds that the foreign nation grants reciprocal copyright protection for U.S. works. 17 U.S.C. §104(b). Other parts of the Copyright Act that refer to foreign operative acts include provisions on:

- Transfers of copyright ownership "executed in a foreign country," 17 U.S.C. §204(b)(2);

- Priorities between conflicting transfers of copyright ownership executed "outside the United States," 17 U.S.C. §205(d);
- The placing of copyright notices on works "published in the United States or elsewhere," 17 U.S.C. §401(a), 402(a);
- The exemption for "Berne Convention works whose country of origin is not the United States" from the requirement that a copyright be registered before commencing an infringement action in a U.S. court, 17 U.S.C. §411(a).

Conversely, Section 201(c) prevents some foreign acts from having the effect of transferring or extinguishing rights under a U.S. copyright:

> [S]ubsection (e) would protect foreign authors against laws and decrees that would divest them of their rights under the United States Copyright Act. It would protect authors within the foreign country who choose to resist such covert pressures.

Senate Rep. No. 94-473, *supra* at 107.

By the same token, Congress did not attempt to legislate every transaction or occurrence in a foreign country that would have legal significance within the United States. For example, a U.S. copyright owner, while residing abroad, may certainly authorize the publication of a book or the performance of a play in the United States. Or, from a foreign base, an author or his or her heirs may terminate transfers and licenses of U.S. rights to others. *See* 17 U.S.C. §203(a) and (b)(5). We have seen that copies made abroad for the U.S. copyright owner are "lawfully made under this title" for purposes of Section 109(a). *Denbicare*, 84 F.3d at 1149-50. A foreign owner of a U.S. copyright can even authorize, from abroad, imports into the United States where that owner has not

itself made a first sale of a particular copy. *See Disenos Artisticos E Industriales S.A. v. Costco Wholesale Corporation*, 97 F.3d 377 (9th Cir. 1996) (authority implied from the foreign owner's license agreements with other foreign companies).

A first sale by the copyright owner is also such an operative act that may occur abroad. As discussed above, the policy against restraints on alienation of goods is at the root of Section 109(a), and it applies whether a U.S. patent or copyright owner has sold its goods in its home market or abroad. *Supra* at 12-17. In the Case 1 scenario, if L'anza's sale of hair products with copyrighted labels occurs in the U.S., in Europe or in transit, the answer is the same. Section 109(a) prevents L'anza from restraining downstream alienation of those particular copies that are "lawfully made under this title" and that L'anza itself has already once sold – and, thus, it cuts off L'anza's "exclusive right to distribute [these] copies . . . under section 106," 17 U.S.C. §602(a).

II.
IMPOSING LIABILITY WOULD VITIATE THE "GOOD FAITH PURCHASER" RULE, IN WAYS CONGRESS COULD NOT HAVE INTENDED.

Should the Court decide, however, that Section 602(a) applies in Case 1, the zone of liability should be limited to those engaged in the sole act proscribed by that section, "importation." For purposes of Section 602(a), Section 501 only provides a right of action against, and defines as an infringer, the person "who *imports* copies or phonorecords into the United States in violation of section 602. . . ." 17 U.S.C. §501(a) (emphasis added). Since it does not appear that Quality King was an importer, it

should not have Section 602(a) liability.[10] Any broader reading would create enormous commercial consequences for U.S. retailers and distributors who, today, are being sued under Section 602(a) for selling goods that are genuine but that were not imported with the U.S. copyright owner's consent.

Normally, a downstream merchandiser may rely on the "good-faith purchaser for value" rule when it acquires merchandise for resale. That rule protects the free transferability of all genuine goods. *See* U.C.C. §2-403. It "allows people safely to engage in the purchase and sale of goods without conducting a costly investigation of the conduct and rights of all previous predecessors in the chain of distribution." *Johnson & Johnson Prod. v. Dal Int'l Trading Co.*, 798 F.2d 100, 104 (3d Cir. 1986) (retailer not liable for selling imported gray market goods that others had fraudulently procured).

Congress preserved normal rules relating to the transfer of personal property, both by Section 109(a) and by making clear that ownership of rights under a copyright is "distinct from ownership of any material object in which the work is embodied." 17 U.S.C. §202. In giving copyright owners a Section 602 remedy that expressly covers only the act of "importation," Congress expressed no intent to sanction merchants who subsequently deal in imported objects with copyrighted labels. Indeed, a contrary interpretation would saddle retailers with a risk of

[10]The district court found that Quality King purchased the L'anza products after they had been imported: "[The products] were imported into the United States where they passed through the stream of commerce until they were purchased by Quality King in the ordinary course of its business." Petition at B3. The court of appeals *incorrectly* stated (without citation to the record) that Quality King imported the products. Petition at A2, A3.

voidable titles to their inventory of such goods purchased from anyone other than the U.S. copyright owner – a risk the good faith purchaser rule is supposed to avoid:

> [T]he law of voidable title [is] a centuries-old concept now codified in 49 States as part of their adoption of the Uniform Commercial Code. . . . The primary rules of voidable title are manageable and few in number. The first is that one who purchases property in good faith and for value from the holder of voidable title obtains good title. The second rule, reciprocal to the first, is that one who acquires property from a holder of voidable title other than by a good faith purchase for value obtains nothing beyond what the transferor held. The third rule is that a transferee who acquires property from a good faith purchaser for value or one of his lawful successors obtains good title, even if the transferee did not pay value or act in good faith.

United States v. 92 Buena Vista Ave., Rumson, 507 U.S. 111, 142 (1993) (Kennedy, J., dissenting) (citations omitted). Of even more concern, retailers deprived of the good faith purchaser rule for imported products with copyrighted labels would be subjected to the Copyright Act's "potent arsenal of remedies." *Sony Corp.*, 464 U.S. at 433.

The lower courts have indirectly carved out limited exceptions to the good faith purchaser rule for goods that are counterfeit or that are not genuine because they misappropriate intellectual property. See *Stabilisierungsfonds Fur Wein v. Kaiser Stuhl Wine Distributors PTY, Ltd.*, 647 F.2d 200, 207-08 (D.C. Cir. 1981) (product label alleged to have misappropriated a common law trademark); *Ford Motor Company v. B & H Supply, Inc.*, 646 F. Supp. 975 (D. Minn. 1986) (a third party's auto parts were sold in counterfeit Ford packaging). This line

of decision has never subjected merchants to liability for selling genuine products made and originally sold by the intellectual property owner itself.

The Ninth Circuit's decision in this case, however, has punched two new holes in the good-faith purchaser shield. First, it imposes Copyright Act liability on merchants if it turns out that genuine goods with copyrighted labels, once distributed by the U.S. copyright owner, were subsequently imported without the copyright owner's permission. Although the good faith purchaser rules should have obviated the need to investigate the chain of title to the L'anza shampoo at issue, even an investigation of the goods in this case would not necessarily have helped. A merchant would have discovered that the goods here were made in the U.S.A., by L'anza, the U.S. manufacturer and U.S. copyright owner. Yet, the Ninth Circuit's approach imposes liability if the complete provenance of the goods is not discovered.

Second, the Ninth Circuit imposes liability on merchants if, somewhere upstream, the copyright owner did not reap the full reward it might have earned. This "full value" rule would require retailers to conduct a pricing investigation before buying a product from a jobber or independent distributor. If the product bears a copyrighted design on its label, the Ninth Circuit tells retailers that they must ask their suppliers what price the copyright owner received on a transaction somewhere upstream – and then somehow determine how that price compares with the potential price the copyright owner might have charged.

The eventual effect of either prong of the Ninth Circuit's assault is evident: there will be fewer (or more costly) purchases of copyrighted goods from *independent* jobbers and traders. As a result, retailers may also

find it more difficult to turn to these jobbers and traders to buy their excess inventories at the end of a season, or when a store wishes to make room for new merchandise. Put another way, the Ninth Circuit's decision in this case creates strong incentives to deal directly with the copyright owner and to eschew the same products when offered by trading companies, jobbers or distributors like petitioner. Inevitably, this will affect supply conditions in secondary markets for goods, and increase prices: with less supply and competition from secondary sources, prices must rise.[11]

Imposing liability in this case would also produce commercially inexplicable results. A retailer could end up with two identical bottles of L'anza shampoo on its shelves, each with a copyrighted label and each manufactured and previously sold by L'anza, the U.S. copyright owner. If one of the bottles had been previously exported but the second bottle had only been sold domestically, the retailer would be liable for selling the former but not the latter. Unless it is given some accurate means of distinguishing the two (such as lot numbers and data on where individual lots were sold), the retailer sells both bottles at its peril. This is precisely the type of burden

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[11] The Court has invoked national policy favoring competition to limit overly broad claims under both the copyright and patent laws. A court may not "enlarge the scope of respondents' statutory monopolies . . . beyond the limits of the grants authorized by Congress." *Sony*, 464 U.S. at 421 (copyright). "[T]his Nation's historical antipathy to monopoly and of repeated congressional efforts to preserve and foster competition" are grounds not to "expand patent rights." *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518, 530-31 (1972) (patent). Statutory monopolies under the patent and copyright laws should be "strictly construed." *Sears Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 230 (1964).

that both the good faith purchaser rule, and the first sale doctrine, were intended to avoid.

These are not theoretical concerns. Almost *any* consumer product is capable of including a label with some copyrighted design element. Most retailers vary their inventory and purchase from distributors or jobbers who are not the U.S. copyright owner. In today's international economy, where goods are purchased from multiple sources and distributed in free trade areas pursuant to treaties like NAFTA, it will not be uncommon for retailers to purchase imported products where the U.S. copyright owner or its designee is not the importer. Being sued for selling such genuine merchandise *will* burden commerce, affect prices, and create the problems of source identification that we have discussed.

Nowhere has Congress expressed any intent to impose these anti-commercial and anti-consumer results, or to do away with established rules that encourage the free transferability of goods. To the contrary, as discussed earlier (*supra* at 12-15), Congress' perpetuation of the first sale doctrine was intended to avoid such restraints on the free alienation of genuine products. In sum, if the Court believes Section 602(a) may be violated by the act of "importation" in the Case 1 scenario, which we dispute, it should make clear that liability cannot extend to non-importing merchants that are good faith purchasers.

CONCLUSION

For the above reasons, the judgment of the court of appeals should be reversed, and the case remanded with a direction to enter judgment for petitioner.

RESPECTFULLY SUBMITTED, this 6th day of August, 1997.

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APPENDIX

MEMBERS OF NATIONAL ASSOCIATION OF CHAIN DRUG STORES

ABC Stores Div. MNS Ltd.
Albertson's, Inc.
American Drug Stores, Inc.
Andorra Neighborhood Pharmacies
Arbor Drugs, Inc.
Ark Drugs
The Arrow Corporation/Arrow Prescription Centers
Arthur Drug Stores Inc.
The Bartell Drug Company
Brooks Pharmacy
Buffalo Pharmacies
CRX Pharmacy
CVS Pharmacy, Inc.
Carr Gottstein Foods Company
City Drug Stores Inc.
City Drugs
Cobom's, Incorporated
Concord Drugs, Inc.
Costco Wholesale
D & W Food Centers, Inc.
Davidson Drugs, Inc.
Discount Drug Mart, Inc.
Downeast Pharmacy, Inc.
Drug Emporium, Inc.
Drug Fair Stores of NJ
Drug World Pharmacies
Drugtown Drugstores
Duane Reade
Eckerd Corporation

Emm-Dee Drug Corporation
Farmacias El Amal
Fedco Professional Pharmacies
Fedco, Inc.
Fred's Inc.
FreeCorp Peabody dba Freedom Drug
Fruth Pharmacy
Genovese Drug Stores, Inc.
Giant Eagle, Inc.
Giant Food Inc., Pharmacy Div. Giant Discount Drug
Grand Union Company
The Great Atlantic & Pacific Tea Co., Inc.
(A&P Supermarket)
Gresham Drugs, Inc.
H-E-B Foods/Drugs Inc.
Hannaford Bros., Co.
Happy Harry's Discount Drugs
Harco Drug, Inc.
Harmon Discount Stores
Hartig Drug Stores
Health Care Professionals
Hi-School Pharmacy, Inc.
Horton and Converse Pharmacies
K&B Services, Incorporated
Keitsch Bros. Inc.
Keystone - Medicine Chest Pharmacies
Kinney Drugs, Inc.
Kmart Corporation
Knight Drugs Inc.
Kopp Drug, Inc.
The Kroger Co.
Lewis Drugs, Inc.
Longs Drug Stores
Marc Glassman Inc.
Marah Drug Stores, Inc.

May's Drug Stores, Inc.
McKay Drugs
Med-X Corporation
Medic Drug
Medicap Pharmacies, Inc.
Medicine Shoppe International, Inc.
Meijer, Inc.
Monahan Pharmacy Inc.
Navarro Discount Pharmacies
NeighborCare Pharmacies
Nelson's Drug Stores
Nortex Drug Distributors Inc.
dba Drug Emporium
Osborn Drugs, Inc.
Owl Drug Stores Inc.
Parkway Drugs
Pathmark Stores, Inc.
Pelton's Drug Stores
The Penn Traffic Company
Phar-Mor, Inc.
Pharmhouse Corp.
Price-Less Drug Stores, Inc.
Publix Super Markets, Inc.
Quick Chek Food & Pharmacy
Randalls Food & Drugs, Inc.
Retired Persons Services, Inc.
Revco D.S., Inc.
Ricky's
Rite Aid Corporation
Ritzman Pharmacies, Inc.
Rock Bottom Stores, Inc.
Rx Plus
RxD Pharmacies Inc.
Safeway Inc.
Sav-Mor Drug Stores

Sav-On Drugs
Savco Drugs, Inc.
Save Mart Supermarkets
Seaway Food Town, Inc.
Service Discount Food & Drugs Inc.
Shaw's Supermarkets
Shelly's Pharmacy, Inc.
Shopko Stores, Inc.
Smith's Food and Drug Centers
Snyder's Drug Stores, Inc.
Star Markets Company, Inc.
The Stop & Shop Supermarket Company
Super D Drugs Inc.
Super Save Drugs, Inc./Owl Pharmacies
SUPERVALU Pharmacies, Inc.
Target Stores, a div. of Dayton Hudson Corp.
Thriftway Drugs
Thrifty White Stores
TOPS MARKETS, INC.
USA Drug
Valco Drug Stores
The Vons Companies, Inc.
Wakefern Food Corp./ShopRite
Wal-Mart Stores, Inc.
Walgreen Co.
Weatherwax Drug Stores
L.F. Widmann, Inc.